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Supreme Court of the United States

OCTOBER TERM, 1944.

No. 1041

JULIAN KENNEDY, JR., *Petitioner,*

v.

EMERALD COAL AND COKE COMPANY, *Respondent.*

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF DELAWARE AND BRIEF IN SUPPORT THEREOF.

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PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

INDEX.

	Page
Summary Statement of the Matter Involved	1
Jurisdiction	2
Questions Presented	2
Material Facts and Proceedings Before the Securities and Exchange Commission and the Courts of Delaware	3
The Parties	3
Nature of the Action	3
Grounds for Decision Below	7
Reason for Granting the Writ	8
Brief in Support of Petition for Writ of Certiorari	11
Opinions Below	11
Jurisdiction	11
Statutes Involved	13
Statement of the Case	13
Specifications of Errors to be urged	13
Summary of Argument	15
I. The Courts of Delaware had jurisdiction to determine whether the Plan, as set forth in the Registration Statement was fair	15
II. The Plan set forth in the Registration Statement was unfair. Petitioner was justified in filing the Bill in Equity	15
III. The Registration Statement and Prospectus could not legally be modified or amended by oral statements of the president of the Respondent Corporation	15
IV. The statement in the Prospectus that Respondent's mine had 42 miles of entry development, whereas, in fact, it had 62 miles on the date of the Prospectus, depreciated the value of Respondent's property, by understating approximately one-third, its then state of development	15
Argument:	
I. The Courts of Delaware had jurisdiction to determine whether the Plan set forth in the Registration Statement was fair	16

Page

II. The Plan set forth in the Registration Statement was unfair. Petitioner was justified in filing the Bill in Equity 16

III. The Registration Statement and Prospectus could not legally be modified or amended by oral statements of the president of Respondent 19

IV. The statement in the Prospectus that Respondent's mine had 42 miles of entry development, whereas, in fact it had 62 miles on the date of the Prospectus (R—I—36), depreciated the value of Respondent's property, by understating, approximately one-third, its then state of development 21

CITATIONS.

Abie State Bank v. *Bryan*, 282 U. S. 765, 773 12
Awotin v. *Atlas Exchange Bank*, 295 U. S. 209, 213.... 12
Frost & Co. v. *Mines Corp.*, 312 U. S. 38, 40 2
Independence Shares Corp. v. *Deckert*, 108 F. 2d 51, 54 16
Judson v. *Buckley*, 130 Fed. 2d, 174, 179, 180..... 17
Mooney v. *Holohan*, 294 U. S. 103 2
Otis and Co. v. *Securities and Exchange Commission*, No. 81, Oct. Term, 1944 12
Scott v. *McNeal*, 154 U. S. 34, 35, 297 U. S. 103..... 2
Texas & Pacific Ry. Co. v. *Abilene Cotton Oil Co.*, 204 U. S. 426 2

United States Constitution:
Fourteenth Amendment, Sec. 1 .....3, 22
Delaware Constitution:
Art. IV, Sec. 12 11

Statutes:
Securities Act of 1933, as amended. Act May 27, 1933, c. 38, Title I, Sec. 1, 48 Stat. 74; 15 U. S. C. A—
Sec. 77a 13
Sec. 10 13
Sec. 11 13
Sec. 16 9

Schedule A—
Sec. 16 9
Sec. 24 13

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No.

JULIAN KENNEDY, JR., *Petitioner,*

v.

EMERALD COAL AND COKE COMPANY, *Respondent.*

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF DELAWARE.

To the Honorable Harlan Fiske Stone, Chief Justice of the United States, and the Associate Justices of the Supreme Court of the United States:

Your petitioner respectfully shows:

A.

SUMMARY STATEMENT OF THE MATTER INVOLVED.

This is a petition for a Writ of Certiorari to review the judgment of the Supreme Court of Delaware, entered November 27, 1944, sustaining the decree entered in the Court of Chancery, dismissing the bill of complaint filed by petitioner. (R.—IV.—2272)

B.

JURISDICTION.

The jurisdiction of this Court is invoked under Section 237 (b) of the Judicial Code, as amended by the Act of February 13, 1925, on the ground that the decision below was a final judgment or decree rendered by the highest court of the State of Delaware in which a decision could be had, which decision denied a title, right, privilege and immunity claimed by petitioner under the Securities Act of 1933, as amended, particularly Section 7 and Schedule A, thereof. The authorities relied on to sustain such jurisdiction are *Texas and Pac. Ry. Co.* v. *Abilene Cotton Oil Co.*, 204 U. S. 426, 51 L. Ed. 553; *Frost and Co.* v. *Mines Corp.*, 312 U. S. 38, 40; *Scott* v. *McNeal*, 154 U. S. 34, 45; *Mooney* v. *Holohan*, 294 U. S. 103.

C.

QUESTIONS PRESENTED.

1. Whether a registration statement and prospectus filed with the Securities and Exchange Commission and issued under the provisions of the Securities Act of 1933, as amended, presents to the stockholders of a corporation a fair plan for the sale of the corporation's capital stock, where such registration statement and prospectus:

(a) Do not provide full and fair disclosure of the character of securities to be sold.

(b) Provide that such rights to subscribe to and purchase shares of capital stock will not be transferable. (R.—I.—33)

(c) Provide that stockholders who desire to exercise such rights will be required to accept the offer and pay the purchase price for the shares within ten days after the mailing of the offer by the company to them. (R.—I.—33)

2. Whether such registration statement and prospectus may be legally modified and amended, by oral statements

made by the president of the corporation, where such prospectus contains a statement that

> "No representative of the company or any other person has been authorized by the company to give any information or to make any representations, other than those contained in this prospectus, and information or representations not herein contained, if given or made, must not be relied upon as having been authorized by the company." (R.—I.—30)

3. Whether the judgment of the Supreme Court of Delaware deprived the petitioner of rights, titles, privileges and immunities vested in him as a stockholder in Respondent corporation specially set up or claimed under a statute of the United States (Securities Act of 1933, as amended) and deprived petitioner of his property without due process of law in violation of Section 1 of the Fourteenth Article of Amendment to the Constitution of the United States.

D.

MATERIAL FACTS AND PROCEEDINGS BEFORE THE SECURITIES AND EXCHANGE COMMISSION AND THE COURTS OF DELAWARE.

1. *The Parties.* The petitioner, Julian Kennedy, Jr. (complainant and appellant below), a stockholder in Emerald Coal and Coke Company, filed his Bill of Complaint on behalf of himself and any other stockholders similarly situated desiring to become parties. (R.—I.—2)

The respondent, Emerald Coal and Coke Company (appellee below), is a corporation organized and existing under the laws of the State of Delaware.

2. *Nature of the Action.* The Bill of Complaint was filed June 24, 1941 in the Court of Chancery of the State of Delaware, praying:

(a) For an injunction restraining the respondent from offering, issuing or selling 122,457 shares of its capital

stock to Pittsburgh Steel Company, Pittsburgh Coke and Iron Company, and Hillman Coal and Coke Company, at $12.00 per share, and that said proposed sale be decreed to be substantially less than the real value of such stock and an actual fraud upon the respondent and its stockholders. (R.—I.—14)

(b) That the offering of said stock, pro rata, to the present stockholders—with the limitation that such rights should not be transferable—be decreed to be arbitrary, unreasonable and contrary to law, in that it deprives the present stockholders of a vested right incident to ownership. (R.—I.—14)

(c) That an injunction issue restraining the offering of said stock with such limitation or any limitation upon the right of transfer by the present stockholders.

(d) That an injunction issue restraining the respondent from entering into a contract with Pittsburgh Coke and Iron Company similar to the existing contract of the respondent with Pittsburgh Steel Company. (R.—I.—11, 15)

The Bill of Complaint states the managerial functions of respondent are performed by officers of Hillman Coal and Coke Company; that four of the seven directors of the respondent are directors of Hillman Coal and Coke Company; that J. H. Hillman, Jr. is the president and director of the respondent; the chairman of the board and a director of Hillman Coal and Coke Company; the president and a director of Pittsburgh Coke and Iron Company and a director and member of the Executive Committee of Pittsburgh Steel Company. (R.—I.—4)

On April 1, 1941, the officers and directors of the respondent filed with the Securities and Exchange Commission, a Registration Statement which became effective June 16, 1941 (R.—I.—6, 29), whereby the respondent proposed to issue 122,457 shares of its capital stock, without par value, having a book value of $99.00 a share, for the price of $12.00 per share, as follows: 30,000 shares to Pittsburgh Coke and

Iron Company, 30,000 shares to Pittsburgh Steel Company, and 62,457 shares to Hillman Coal and Coke Company. (R.—I.—6, 32, 33)

Under date of August 14, 1940, J. H. Hillman, Jr. as president of respondent, made to Pittsburgh Steel Company an irrevocable offer (to continue for twenty years) to execute with Pittsburgh Steel Company such lawful contracts or options as from time to time should be necessary in order to obligate the respondent to deliver to Pittsburgh Steel Company from respondent's mine a supply of suitable high volatile coal adequate to meet all or at least 80 per centum, as Pittsburgh Steel Company desires, of the annual requirements of its Monessen and Allenport plants, at lawful prices. (R.—I.—11, 38)

It was proposed to make a similar contract to furnish coal to Pittsburgh Coke and Iron Company. (R.—I.—39)

The foregoing sale of capital stock was made subject to first being offered, pro rata, to the stockholder at $12.00 per share. Such rights to purchase were not transferable and stockholders were required to accept the offer and pay the purchase price for the shares within ten days after the mailing of the offer to them. (R.—I.—33)

The stockholders were not offered an irrevocable contract or option to purchase coal for twenty years, if they purchased their pro rata share of stock, nor any other coal contract or option.

At a special meeting of the stockholders on July 14, 1941 held after said Registration Statement had become effective (R.—I.—103), J. H. Hillman, Jr., president of respondent and chairman of the meeting, stated contrary to the prospectus, that the three companies who had agreed to buy the stock under the refinancing plan had indicated to him their willingness, notwithstanding the expiration of the subscription period, to sell to any stockholder the number of shares to which he would have been entitled under his subscription right and this offer was still open for a reasonable length of time to any stockholder. He further stated that no

objections would be made if any stockholder would assign his right under this offer. (R.—I.—121)

No amendment to the Registration Statement and Prospectus was made nor was any authority produced authorizing the making of above statements.

Over 10,700 shares of stock were not represented at the meeting. The owners of said stock were without notice of such statements at the above meeting.

On or about August 18, 1941 the issue of 122,457 shares of stock was sold to the above named corporations.

No amendment to the Registration Statement or Prospectus was made subsequent to said meeting of the stockholders.

At the trial (January 1942) the evidence showed that the contracts for coal and the purchase of the shares of stock were one transaction, and that neither Pittsburgh Steel Company nor Pittsburgh Coke & Iron Company wanted the shares of stock unless they had the contracts for coal. For $12.00 per share each of these corporations had received 30,000 shares of stock and a twenty-year contract for coal, both of which were material contracts, made not in the ordinary course of business, executed after the filing of the Registration Statement, and not set forth in the Registration Statement. (R.—I.—253; II.—1073; III.—1476; VI.—3786)

The Registration Statement did not disclose:

1. That by virtue of pre-existing contract obligations, Hillman Coal and Coke Company was obligated to Pittsburgh Steel Company and Pittsburgh Coke and Iron Company to provide them, from other mines, with suitable and adequate long-term supply of coal at their plants.

2. That Pittsburgh Steel Company's coal mines were practically exhausted. (R.—II.—744)

3. That respondent's mine was the only mine known to J. H. Hillman, Jr. which could furnish Pittsburg Steel with

the quantity and quality of coal needed at two of its plants. (R.—II.—744, 745)

4. That the contract of W. J. Rainey, Inc., a Hillman company, to furnish coal to Pittsburgh Coke and Iron Company from the Clyde Mines, had to be transferred to another source of supply before the Clyde Mines could be sold by Hillman to Republic Steel Corporation. (R.—II.—751, 752)

5. That the entry development upon respondent's property was 62 miles (R.—V.—32, 80) instead of 42 miles, as alleged in the Registration Statement. (R.—I.—36) This fact was not disclosed until February 1943.

As to this untrue statement of a material fact, the Supreme Court of Delaware said in its opinion: (R.—4087)

> "The statement made in the prospectus of June 17, 1941, that the respondent's mine had 42 miles of developed entries whereas, in fact, it had 62 miles on that date, was an error of the respondent's engineers to which attention was called by Mr. Affelder himself at the Washington hearing. The complainants do not contend that they refused to exercise their subscription rights because of the error, and, at best, it has little or no importance."

3. *Grounds for Decision Below.* The Vice-Chancellor held in his opinion:

> "Upon consideration of the evidence, I find that the plan is fair, and that the prayers for an injunction should be denied." (R. —IV.—2263)

Thereupon judgment was entered, November 27, 1942, dismissing the Bill of Complaint (R.—IV.—2272), from which petitioner took a Writ of Error out of the Supreme Court of Delaware, June 2, 1943. (R.—IV.—2268)

In an opinion, dated February 9, 1943, the Vice-Chancellor in disposing of the costs, said: (R.—IV.—2267)

> "Here, however, at the time of the institution of this suit, and until the stockholders' meeting in July, 1941,

> various circumstances, including the interlocking directorate relationship between respondent and the corporations with which it was dealing, the short period allowed to stockholders to exercise their pre-emptive rights, the terms of the offering to stockholders, and other facts concerning the adoption and putting forward of the refinancing plan, gave such apparent support to the case stated in the bill that they might be expected normally to impel a reasonable man, situated as was the original complainant, to bring suit. From these circumstances, coupled with the complainant's entire good faith, it follows that the complainant was "justified", in the sense that this term is used in *Wittenberg* v. *Federal Mining & Smelting Co.*, 15 Del. Ch. 351, 355, 138 A. 352, in filing his bill of complaint. But this "justification" did not extend beyond the stockholders' meeting. The action taken at this meeting went far to demonstrate the propriety of what the corporation had previously done, as well as what was proposed for the future."

The Supreme Court, in an opinion by Chief Justic Layton, held: (R.—4079)

> "The opinion of the Vice-Chancellor is thoroughly satisfactory. His findings of facts and conclusions were based upon a searching appraisal of the testimony before him, and being amply supported by the evidence, will not be disturbed."

E.

REASONS FOR GRANTING THE WRIT.

The court below held a plan for sale of shares of stock in a corporation and a prior offer to the stockholders to be fair where the Registration Statement and Prospectus:

1. Contained an untrue statement of a material fact and omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading. (Securities Act of 1933, Sect. 11a)

2. Did not disclose a variation from the price at which it was proposed that the shares should be offered to the stockholders, and the price such shares and two twenty-year coal contracts were proposed to be offered to two corporations. (Securities Act of 1933, Schedule A, 16)

3. Did not set forth dates of and parties to, and the general effect concisely stated of every material contract made, not in the ordinary course of business, which contract was to be executed in whole or in part at or after the filing of the Registration Statement, or which contract had been made not more than two years before such filing. (Securities Act of 1933, Schedule A, 16)

4. The plan for the sale of the stock was governed by the provisions of the Securities Act of 1933, as amended (*An Act to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof, and for other purposes*) and the construction of said federal statute was necessarily involved in determining whether said plan was fair.

5. The questions are of importance and substance. No plan can be said to be fair which violates the express provisions of a federal statute, enacted to prevent frauds in the sale of securities, and which is based upon a Registration Statement that the Court held justified the filing of a bill in equity to set aside.

Wherefore your petitioner prays that a Writ of Certiorari be granted under the seal of this Court directed to the Supreme Court of Delaware, to the end that this cause be reviewed and determined by this Court as provided by the

Statutes of the United States; and for such relief as to this Court may seem proper.

Dated this 23rd day of February, 1945.

Respectfully submitted,

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LEONARD K. GUILER,
Attorneys for Petitioner,
Investment Building,
Washington, D. C.

PETITIONER'S

BRIEF

Supreme Court of the United States

OCTOBER TERM, 1944.

No.

JULIAN KENNEDY, JR., *Petitioner,*

v.

EMERALD COAL AND COKE COMPANY, *Respondent.*

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

A.

OPINIONS BELOW.

The opinions of the Chancery Court are reported in 28 A. 2d 433 and 30 A. 2d 269.

The decree of the Chancery Court appears in Vol. IV page 2272 of the Record.

The opinion and decree of the Supreme Court of Delaware are unreported. (February 15, 1945)

B.

JURISDICTION.

1. The judgment sought to be reviewed is by the highest Court of the State of Delaware in which a decision could be had. Constitution of Delaware Art. IV, Sect. 12.

2. The Federal question was raised in the Court of first instance, by allegations of the Bill in Equity in the Chancery Court. (R.—I.—33)

3. The Federal question was raised in the Supreme Court of Delaware by assignments of error, alleging violation of the Constitution and laws of the United States. (R.—IV.—2272; VI.—4031, 4040)

4. The judgment of the Supreme Court of Delaware was based upon an interpretation of the Securities Act of 1933, and is reviewable here.

Awotin v. *Atlas Exchange Bank*, 295 U. S. 209, 213.

5. The decision below denied a title, right, privilege or immunity claimed by petitioners under the Securities Act of 1933.

6. The judgment of the Supreme Court of Delaware does not rest upon a non-federal ground which independently and adequately supports its judgment. The Supreme Court of the United States has jurisdiction to review a decision of a state court involving both a federal and non-federal ground where the non-federal ground is so interwoven with the federal ground as not to be an independent matter, or is not of sufficient breadth to sustain the judgment without a decision of the other ground.

Abie State Bank v. *Bryan*, 282 U. S. 765, 773.

7. The questions raised are of importance in the administration of the Securities Act of 1933.

Otis and Co. v. *Securities and Exchange Commission and the United Light and Power Co.*, No. 81 October Term, 1944, decided January 29, 1945, where this Court held book value an element to be considered in the valuation of a corporation's stock, by the Securities and Exchange Commission in approving a Plan to be fair and equitable, under the Public Utility Holding Company Act of 1935, 49 Stat. 803.

C.

STATUTE INVOLVED.

Securities Act of 1933, as amended. Particularly sections 10, 11, 16; Schedule A, sections 16 and 24, Act of May 27, 1933, c. 38 Title I, Sect. 1; 48 Stat. 74; 15 U. S. C. A. Sect. 77a.

D.

A statement of the case has been given under heading "D" in the petition.

SPECIFICATION OF ERRORS TO BE URGED.

1. The Supreme Court of Delaware erred in entering the following decree: (R.—4070)

> "No. 2 May Session, 1943; No. 1 February Session, 1944.
>
> ORDER
>
> On this twenty-seventh day of November, A. D. 1944, it is ORDERED,
>
> 1. that the decree entered in the Court below dismissing the bill of complaint, be sustained; (R.—IV.—2272)
> 2. that the decree entered in the Court below dismissing the complainants' petition for leave to file a bill of review, be sustained;
> 3. that the petition filed in this Court for leave to amend a proposed bill of review, be dismissed.
>
> And it is further ORDERED,
>
> that upon the filing of the Court's opinion herein the Clerk of this Court send to the Attorneys of record a copy thereof, together with the date of filing the opinion;
>
> And it is further ORDERED,
>
> that the Clerk of this Court send forthwith to Richards, Layton & Finger, Solicitors for the appellee, and to William S. Potter, and to Houston Wilson, Solicitors for the appellants, a copy of this order:
>
> DANIEL J. LAYTON,
> *Chief Justice*"

2. The Supreme Court of Delaware erred in entering the following decree: (R.—4070)

And now to wit, this 23rd day of January, A. D. 1945, the above cause having been argued by the Solicitors for the parties respectively,

And it appearing to the Court that there is no error in the record and proceedings in said cause in the Court of Chancery of the State of Delaware in and for Sussex County,

It Is Thereupon Ordered, Adjudged and Decreed that the decree of the said Court in said cause be, and it is hereby affirmed and that the complainants below, appellants, pay the costs of said cause in this Court, hereby taxes in the sum of Thirty Six Dollars and Fifty-nine cents ($36.59).

And, Further, that the Clerk of this Court remit to the said Court of Chancery a duly certified copy of this Decree, with the Opinion of this Court filed in this cause, in order that such further proceedings may be had in said Court in said cause in conformity with this Decree as may be necessary.

DANIEL J. LAYTON, C. J.
RICHARD S. RODNEY, J.
F. L. SPEAKMAN, J.
CHARLES L. TERRY, JR., J.

3. In its opinion by holding that:

> "The statement made in the prospectus of June 17, 1941, that the respondent's mine had 42 miles of developed entries whereas, in fact, it had 62 miles on that date, was an error of the respondent's engineers to which attention was called by Mr. Affelder himself at the Washington hearing. The complainants do not contend that they refused to exercise their subscription rights because of the error, and, at best, it has little or no importance." (R.—4087)

4. In its opinion by holding that: (R.—4079)

> "The opinion of the Vice-Chancellor is thoroughly satisfactory. His findings of facts and conclusions were

based upon a searching appraisal of the testimony before him, and being amply supported by the evidence, will not be disturbed."

The Vice-Chancellor in his opinion held:

"Upon consideration of the evidence, I find that the plan is fair, and that the prayers for injunction should be denied." (R.—IV.—2263)

5. In its opinion by approving the attempted oral changes in the terms of the prospectus, relative to the offering of the shares of stock to the stockholders.

6. In depriving petitioner of rights, titles, privileges and immunities, vested in him as a stockholder in respondent corporation and claimed under a statute of the United States (Securities Act of 1933, as amended) and in depriving petitioner of his property without due process of law, in violation of Section 1 of the Fourteenth Article of Amendment to the Constitution of the United States.

SUMMARY OF ARGUMENT.

I.

The courts of Delaware had jurisdiction to determine whether the plan, as set forth in the registration statement was fair.

II.

The plan set forth in the registration statement was unfair. Petitioner was justified in filing the bill in equity.

III.

The registration statement and prospectus could not legally be modified or amended by oral statements of the president of the respondent corporation.

IV.

The statement in the prospectus that respondent's mine had 42 miles of entry development, whereas, in fact it had 62 miles on the date of the prospectus, depreciated the value of respondent's property, by understating, approximately one-third, its then state of development.

ARGUMENT.

I.

The Courts of Delaware Had Jurisdiction to Determine Whether the Plan Set Forth in the Registration Statement was Fair.

Section 16, Title I, of the Securities Act of 1933, as amended, provides:

> "The rights and remedies provided by this subchapter shall be in addition to any and all other rights and remedies that may exist at law or in equity." 15 U. S. C. A. 77 p.

This section "does not relate to venue or enlarge the remedy given by the act to a defrauded person, but Congress sought only to make it clear that it was not pre-empting the field to the federal jurisdiction, thereby prohibiting recovery to a defrauded person under the law of the states as it existed before passage of the act."

> *Independence Shares Corporation* v. *Deckert*, 108 F. 2d 51, 54.

II.

The Plan Set Forth in the Registration Statement was Unfair. Petitioner was Justified in Filing the Bill in Equity.

In *Frost & Co.* v. *Mines Corp.*, 312 U. S. 38, 43; 85 L. Ed. 500, the Supreme Court quotes an excerpt from Memorandum of the Securities and Exchange Commission, in part as follows:

> "The fundamental purpose of the Securities Act of 1933 * * * is to protect the investing public. The Act furnishes one form of protection by insisting that 'every issue of new securities to be sold in interstate commerce shall be accompanied by full publicity and information' to the end that 'no essentially important element attending the issue shall be concealed from the

buying public.' Message of the President to the Congress, March 29, 1933."

In the above case the Supreme Court of Idaho held a public offering of treasury stock of a corporation, not registered under the Securities Act of 1933, to be void and an option to purchase such stock, unenforceable.

This Court, on Certiorari, reversed the state court, stating in its opinion:

> "No provision of the Act declares that in the absence of registration contracts in contemplation of or having relation to a public offering shall be void." (41)

In the case at bar, a Registration Statement was filed and the majority of Respondent's directors not only assumed the burden of showing the entire fairness of the transaction but were required under the Securities Act of 1933, "to provide full and fair disclosure of the character of the securities sold," in the Registration Statement.

Contracts made in violation of the Securities Act cannot be enforced when they are calculated to damage the investing public, each case must be judged upon its own facts.

The Registration Statement and Prospectus should have been amended.

> *Judson* v. *Buckley*, 130 Fed. 2d 174, 179, 180. Certiorari denied, 317 U. S. 679.

The Vice-Chancellor said in his opinion: (R.—IV.—2245)

> "By reason of the relationship of the majority of respondent's directors to the three other companies involved in the plan, they, or those who would uphold the plan, 'assumed the burden of showing the entire fairness of the transaction.'"

> *Keenan* v. *Eshleman*, 2 A. 2d 904 (R.—IV.—2245).

The Supreme Court said: (R.—4076)

> "The learned Vice-Chancellor properly applied the rule laid down by this Court in Keenan v. Eshleman

(Del. Ch., 2A. 2d. 904, 120 A. L. R. 227, that the contracts being between corporations having directors in common, the proponents of the transaction must assume the burden of showing its entire fairness both with respect to the plan of re-financing and the concomitant contracts."

The Vice-Chancellor said in his opinion: (R.—IV.—2267)

"Here, however, at the time of the institution of this suit, and until the stockholders' meeting in July 1941, various circumstances, including the interlocking directorate relationship between respondent and the corporations with which it was dealing, the short period allowed to stockholders to exercise their pre-emptive rights, the terms of the offering to stockholders, and other facts concerning the adoption and putting forward of the refinancing plan, gave such apparent support to the case stated in the bill that they might be expected normally to impel a reasonable man, situated as was the original complainant, to bring suit. From these circumstances, coupled with the complainant's entire good faith, it follows that the complainant was 'justified', in the sense that this term is used in *Wittenberg* v. *Federal Mining & Smelting Co.*, 15 Del. Cr. 351, 355, 138 A. 352, in filing his bill of complaint. But this 'justification' did not extend beyond the stockholders' meeting. The action taken at this meeting went far to demonstrate the propriety of what the corporation had previously done, as well as what was proposed for the future."

The minutes of the Stockholders' Meeting of July 14, 1941 (R.—I.—103), show that no information was given the stockholders by the common officers and directors of the three corporations interested, tending to show the entire fairness of the offering contained in the Prospectus.

It was not until the trial of the case in January 1942, that petitioner learned various facts, which were important elements entering into the value of the Respondent's properties. (Pages 6, 7 of Petition for Writ.)

It was not until February, 1943, that the amount of de-

velopment in Respondent's mines was revealed. A registration statement that does not disclose facts of this character is a fraud on the stockholders who have a pre-emptive right to purchase a pro rata share of the proposed issue of stock. It must be presumed that all the facts disclosed at the trial were known to the three corporations having directors in common, at the time the Registration Statement was filed.

III.

The Registration Statement and Prospectus Could Not Legally be Modified or Amended by Oral Statements of the President of Respondent.

On the first page of the Prospectus, appeared the following: (R.—I.—30)

> "No representative of the Company or any other person has been authorized by the Company to give any information or to make any representations, other than those contained in this Prospectus, and information or representations not herein contained, if given or made, must not be relied upon as having been authorized by the Company."

In the face of this statement and admonition to the stockholders, at a special meeting of the stockholders on July 14, 1941, (R.—I.—103) (held after said Registration Statement had become effective and the pre-emptive right of the stockholders to purchase their pro rata share of the proposed issue of stock had expired) J. H. Hillman, Jr., President of Respondent and Chairman of the meeting, stated (contrary to the Prospectus), that the three companies who had agreed to buy the stock under the refinancing plan had indicated to him their willingness, notwithstanding the expiration of the subscription period, to sell to any stockholder the number of shares to which he would have been entitled under his subscription right and this offer was still open for a reasonable length of time to any stockholder. He

further stated that no objections would be made if any stockholder would assign his right under this offer. (R.—I.—121)

The Vice-Chancellor said in his opinion: (R.—IV.—2267)

> "The action taken at this meeting went far to demonstrate the propriety of what the corporation had previously done, as well as what was proposed for the future."

He further said:

> "This 'justification' (petitioners justification in filing the bill) did not extend beyond the stockholders' meeting."

In passing on this question the Supreme Court said: (R.—4076)

> "Objection was made by the complainants that the ten day limitation imposed for the exercise of subscription rights was too short a time for a considerate exercise of the right, and objection was also made to the provision against assignment of the rights. Thereupon, an offer was made that the three companies would, for a reasonable time, sell at $12.00 a share to any stockholder the number of shares to which he would have been entitled to subscribe, and that no objection would be made to an assignment of subscription rights. And, at the trial, on behalf of the respondent an offer was placed on record to sell to the complainants at $12.00 a share all or any part of the shares received by Hillman Coal and Coke Company under the plan of refinancing, the offer to remain open until the close of the hearing. No stockholder availed himself of the offers."

It is not strange that no stockholder availed himself of the offers.

When the offers were made in July 1941, those charged with the burden of showing the entire fairness of the plan, had made no effort to discharge the burden, which the law cast upon them. There was no attempt to show that J. H. Hillman, Jr., had the authority to make the representations

and offers to the stockholders. It was an attempt to extend the unreasonable period of the ten-day offering of the stock to the old stockholders to a "reasonable period of time" and to eliminate the non-transferable feature of the rights to subscribe. The offer placed on the record by Respondent's counsel was to remain open only until the close of the hearing.

All of these so-called offers were an attempt to evade the legal necessity of amending the Prospectus and would not have relieved Respondent from the two twenty-year coal contracts. All violated the Securities Act of 1933, and the Prospectus issued by Respondent, as required by said Act.

As a result of the execution of the plan, Hillman Coal & Coke Company, Pittsburgh Steel Company and Pittsburgh Coke & Iron Company became the owners of seventy-four (74%) per centum of the issued capital stock of Respondent, having a book value of $4,193,879, for which they paid $1,-109,484; (R.—I.—9) and in addition they received two twenty-year coal contracts, for which they paid nothing. These contracts were valuable and assignable to other consumers of coal. (R.—VI.—3790)

They were to the prejudice of the minority shareholders, whose pre-emptive right to take their pro rata share of the offering, was subordinate to such contracts. (R.—I.—252, 254)

It is settled law that the majority shareholders of a corporation, can not use their control for their own selfish interests, and are held to be a trustee for the minority shareholders to whom they must account for profits improperly made to the prejudice of the minority.

The duty of the majority shareholders to make pro rata distribution of the fruits of its control on equal terms among the minority, is fiduciary and not dependent upon fraud or mismanagement.

Southern Pacific Co. v. *Bogert*, 250 U. S. 483, 492.

In the above case the Court said: "The wrong lay not in acquiring the stock, but in refusing to make a pro rata dis-

tribution on equal terms among the old Houston Company shareholders."

In the case at bar, the stock was not only wrongly acquired, in violation of a Federal statute, but the old shareholders were denied a pro rata share in the fruits of the coal contracts which the majority shareholders were enabled to acquire by violation of the law.

IV.

The Statement in the Prospectus That Respondent's Mine had 42 Miles of Entry Development, Whereas, in Fact It had 62 Miles on the Date of the Prospectus (R—I—36, Depreciated the Value of Respondent's Property, by Understating, Approximately One-Third, Its Then State of Development.

This "mistake" was not disclosed by Respondent's engineer until February, 1943. (R.—V.—32, 80)

The Supreme Court said:

> "The complainants do not contend that they refused to exercise their subscription rights because of the error, and, at best, it has little or no importance." (R.—4087)

There was no evidence to support this finding.

When the case was tried in the Chancery Court, it was assumed that the statement in the Prospectus, that "the present development upon the properties includes 42 miles of entries in the mine" was true, and this assumption continued until after the decision of the Chancery Court.

The Prospectus stated: (R.—I.—36)

> "The present stage of development of the property permits an average daily production of 2,100 tons of coal."

It is contended petitioner was entitled to know the entry development, that it was an important element entering into the value of the stock offered, and a violation of the Securities Act to understate the amount thereof.

It was a fact known to the Respondent and its engineers, of which petitioner had no notice nor opportunity to ascertain.

To one familiar with coal mining, twenty miles of entry development is not of "little or no importance."

It could easily be the difference between a profit and loss in mining operations—between a productive coal property and one in the development stage.

Without notice, nor opportunity to be heard, the Supreme Court of Delaware, with no evidence to support its finding, deprived petitioner of his property without due process of law.

It is settled law that,

> "These prohibitions (14th Amendment) extend to all acts of the State, whether through its legislative, its executive, or its judicial authorities."
>
> *Scott* v. *McNeal*, 154 U. S. 34, 35.
>
> "The 14th Amendment governs any action of a state, 'whether through its legislature, through its courts, or through its executive or administrative officers.' "
>
> *Mooney* v. *Holohan*, 294 U. S. 103.

Respectfully submitted,

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Office - Supreme Court, U. S.
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NOV 31 1945
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1944.

NO. 1041.

JULIAN KENNEDY, JR., Petitioner,

v.

EMERALD COAL AND COKE COMPANY,
Respondent.

BRIEF OF EMERALD COAL AND COKE COMPANY, RESPONDENT, IN OPPOSITION TO PETITION OF JULIAN KENNEDY, JR. FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF DELAWARE.

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INDEX.

PAGE

Summary of Argument 1

Argument 4

I. The fairness of Respondent's Refinancing Plan is the sole issue in the Case and involves no Federal question..... 4

II. The Registration Statement and Prospectus were not modified by oral Statements of the Respondent's President..... 4

III. No Question of Public Importance is Involved 6

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SUMMARY OF ARGUMENT.

The Respondent, Emerald Coal and Coke Company, opposes the granting of a writ of certiorari in this case. The decision of the Supreme Court of Delaware (R. 4070, *et seq.*), affirming the Decree of the Court of Chancery of Delaware (R-IV-2236), is unquestionably sound. The sole issue involved was whether Respondent's Plan of Refinancing, adopted by its Board of Directors and approved by the overwhelming majority of

its stockholders, was fair to Respondent and its stockholders. The Vice-Chancellor of Delaware found, upon a consideration of the evidence, that the plan was fair (R-IV-2263), and that finding was fully sustained by the evidence. The Supreme Court of Delaware approved the finding (R. 4079):

> "The opinion of the Vice-Chancellor is thoroughly satisfactory. His findings of fact and conclusions were based upon a searching appraisal of the testimony before him and being amply supported by the evidence will not be disturbed."

The Respondent was in dire financial straits and some recapitalization or reorganization was imperative. Its Board of Directors adopted a plan, which was subsequently approved by an overwhelming majority of the stockholders, involving the sale of an issue of capital stock to three other companies, but proposed first to offer the stock to the existing stockholders. Only one stockholder holding six shares exercised his rights and he is not a complainant here. Although none of the other stockholders exercised their rights and the time for such exercise had passed, the three companies who were to buy the stock, if the stockholders did not take it up, offered orally to sell stock to the stockholders notwithstanding that the subscription period had expired. Still none of the other stockholders elected to purchase.

The registration statement filed with the Securities and Exchange Commission was voluminous and contained all the details of the financial affairs of the Company. During the course of a hearing before the bituminous Coal Division of the United States Department of the Interior, about one year after the trial in Dela-

ware, it was discovered that there was a mistake in the registration statement, in that it stated that the developed track mileage was 42 miles, whereas in fact it was 62 miles. The Vice-Chancellor of Delaware held that this was an error not material and dismissed a Petition for a Bill of Review raising that point, among others. This point was also before the Supreme Court of Delaware on an appeal from the dismissal of the Bill of Review and the Court dismissed the appeal.

No Federal question is involved. The Petitioner has no right of action under the Federal Securities Act because he did not purchase stock on the faith of the Registration Statement and Prospectus. He therefore has no standing to complain in a Federal Court either that existing stockholders were not permitted to assign their subscription rights or that the Prospectus contained a mistatement. Furthermore, neither question is of such public importance as to warrant the issuance of this Writ.

Petitioner's numerous co-complainants in the Delaware courts have not joined in this Petition.

The facts stated by Petitioner, commencing on page 3 of his Petition are, in most respects, sustained by the record. However, we will have occasion to point out certain inaccuracies therein in the course of our argument.

ARGUMENT.

I.

The fairness of Respondent's Refinancing Plan is the sole issue in the Case and involves no Federal Question.

Petitioner admits in Section I of his argument that the Delaware courts had jurisdiction to decide whether the Respondent's Plan of Refinancing, set forth in its Registration Statement, was fair, which, as stated above, was the sole issue in the case. Respondent is in full agreement on that point and submits that that disposes of Section II of Petitioner's Argument. Surely this Court will not assume jurisdiction to review the findings of the Vice-Chancellor of Delaware, based upon substantial evidence, and affirmed by the Supreme Court of Delaware, to the effect that the Plan was fair. No Federal question is involved in that aspect of the case, and further comment seems unnecessary.

II.

The Registration Statement and Prospectus were not modified by oral Statements of the Respondent's President.

Petitioner's contention to the contrary, in Section III of his Argument, is not sustained by any testimony in the case. The facts are stated correctly by Petitioner on page 5 of his Petition, but the conclusion drawn therefrom is grossly inaccurate. As clearly appears from that statement, the Respondent did not enlarge the time for subscribing, nor change the provisions of

the Registration Statement with respect to the assignability of the subscription rights.

What actually happened, as disclosed by the record, was that the three companies who had agreed to buy all the stock to be issued under the Plan, which was not taken up pro rata by existing stockholders, had informed the Respondent's President that they would sell stock, which was to be allotted to them, to any stockholder at the price and in the amount to which he was entitled under the Plan, within a reasonable period, and if such stockholder wanted to assign his right in such offer, such assignment would be recognized. Obviously the Respondent was not making the offer and could not have made such an offer, because it had already committed itself to these three companies to sell to them all of the stock not subscribed for by the old stockholders.

At the trial of the case before the Vice-Chancellor of Delaware, this offer was repeated (R. 4076) by one of the companies which had acquired stock under the Plan. No stockholder availed himself of either of these opportunities to subscribe. It thus clearly appears that the price of $12.00 per share, at which the stock was sold, and the maner in which it was sold pursuant to the Registration Statement and Prospectus, was not unfair to existing stockholders, and the reasons therefor were amply demonstrated by the evidence. A specification of this evidence would not seem to be required in view of the findings and conclusions of the Vice-Chancellor of Delaware, which the Supreme Court of Delaware, as aforesaid, characterized as "thoroughly satisfactory."

The book-value of $99.00 a share to which Petitioner refers on page 4 of his Petition, was fully explained and conclusively shown to have no relation whatever to the actual value of the stock. The Vice-Chancellor of Delaware so found (R-IV-2252), which finding the Supreme Court of Delaware approved (R. 4079).

In any event, an oral modification of a Registration Statement and Prospectus of the character alleged, even if proved, which we deny, does not give Petitioner, a non-investor, a right of action under the Federal Securities Act.

III.

No Question of Public Importance is Involved.

In Section IV of his Argument, Petitioner refers to the engineering error in the Prospectus relating to the state of development of Respondent's coal mine, viz: 42 miles of entry development as against 62 miles, the actual figure. The Prospectus was a voluminous document, giving great detail respecting the history of the property, current and prospective daily production, remaining unmined tonnage, financial statements, amounts previously spent on carrying charges, and on development, and a great many other matters (R-I-29, *et seq.*). The one item which Petitioner claims was inaccurate appears at page 36 of Volume I of the record, viz:

> "The present development upon the property includes 42 miles of entries in the mine, of which approximately 7 miles are equipped with haulage roads of permanent construction."

The Respondent's explanation was that such figure of 42 miles did not include 20 miles of inactive, non-productive entries in a developed mine which Respondent had purchased. It was accurate as to the development made in the course of Respondent's operations.

It is true that the initial discovery by Respondent of this error, and its voluntary disclosure thereof to the Petitioner and his co-complainants in the Delaware proceedings, were not made until a year after the original trial before the Vice-Chancellor. However, among many other items, it was a matter of consideration by the Vice-Chancellor of Delaware upon a Petition for Leave to file a Bill of Review filed by Petitioner and his co-complainants on May 25, 1943 (R-IV-2273, at 2315, 2316). In his opinion advising the dismissal of that Petition, the Vice-Chancellor stated that the error was not of sufficient importance to affect the ultimate result of the case (Supp. R. 28, 29). The Supreme Court of Delaware concurred in this conclusion (R. 4086).

We submit that the number of miles of entry development is not the vital factor that weighs with a prospective investor in a coal company. The more important factor is its productive capacity, and there is no claim that the actual production was misrepresented. In fact, Petitioner, at page 22 of his Petition and Brief herein, quotes the Prospectus (R-I-36) to the following effect:

> "The present stage of development of the property permits an average daily production of 2,100 tons of coal."

Whether this amount of daily production came from a mine with 42 or with 62 miles of entries would seem

to be immaterial on the question of the value of the stock of Respondent.

The argument that a writ of certiorari should be granted to review the decision of the courts of Delaware on this unimportant point seems highly tenuous.

The Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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